

NEW ISSUE

BOOK-ENTRY ONLY

This cover page contains certain information for quick reference only. It is not a summary of the issue. Investors must read the entire Official Statement to obtain information essential to the making of an informed investment decision.

OFFICIAL STATEMENT

**STATE OF TENNESSEE
\$215,165,000 General Obligation Bonds, 2004 Refunding Series C**

Dated: August 15, 2004

Due: September 1 as shown on inside front cover

The Bonds

Interest payable semi-annually March 1 and September 1, commencing March 1, 2005.
Interest rates and reoffering prices/yields as shown on inside front cover.

Fully registered bonds issued in denominations of \$5,000 or any integral multiple thereof.

Not subject to redemption prior to maturity.

See "The Bonds" herein.

Security

Direct general obligations; pledge of full faith and credit. See "Security for the Bonds" herein.

Book-Entry Only System

The Depository Trust Company. See Appendix D.

Tax Exemption

Interest on the Bonds is excluded from gross income for Federal income tax purposes to the extent and subject to the conditions, limitations and continuing compliance with tax covenants as described herein. The Bonds, and the interest thereon, are free from Tennessee taxes, subject to certain exceptions. See "Tax Matters" herein.

The Bonds are offered when, as and if issued and received by the Underwriters, subject to certain conditions, including the approval of legality by Hawkins Delafield & Wood LLP, Bond Counsel to the State. Certain legal matters in connection with the Bonds are subject to the approval of the Attorney General and Reporter of the State of Tennessee, as counsel to the State, and Bass, Berry & Sims, PLC, counsel to the Underwriters. The Bonds are expected to be delivered in New York, New York, through the facilities of The Depository Trust Company on or about September 30, 2004.

UBS FINANCIAL SERVICES INC.

CITIGROUP

MERRILL LYNCH

MORGAN KEEGAN & COMPANY, INC.

August 18, 2004

\$215,165,000 GENERAL OBLIGATION BONDS, 2004 REFUNDING SERIES C

<u>Due September 1</u>	<u>Amount</u>	<u>Interest Rate</u>	<u>Yield</u>	<u>Cusip Number*</u>
2007	\$5,455,000	3.000%	2.070%	880541ER4
2008	2,875,000	3.000%	2.500%	880541ES2
2008	2,525,000	5.000%	2.500%	880541ET0
2009	8,785,000	5.000%	2.820%	880541EU7
2010	27,485,000	5.000%	3.040%	880541EV5
2010	875,000	3.250%	3.040%	880541EW3
2011	26,110,000	5.000%	3.260%	880541EX1
2011	2,250,000	3.500%	3.260%	880541EY9
2012	33,960,000	5.000%	3.420%	880541EZ6
2012	1,750,000	3.625%	3.420%	880541FA0
2013	28,385,000	5.250%	3.580%	880541FB8
2014	28,465,000	5.250%	3.690%	880541FC6
2015	24,010,000	5.250%	3.800%	880541FD4
2016	11,125,000	5.000%	3.880%	880541FE2
2017	11,110,000	5.000%	3.960%	880541FF9

*These CUSIP numbers have been assigned by Standard & Poor's CUSIP Service Bureau, a Division of The McGraw Hill Companies, Inc., and are included solely for the convenience of the Bondholders. Neither the State of Tennessee nor the Underwriters are responsible for the selection or use of these CUSIP numbers, nor is any representation made as to their correctness on the Bonds or as indicated herein.

THE FUNDING BOARD OF THE STATE OF TENNESSEE

Phil Bredesen, Governor, *Chairman*
John G. Morgan, Comptroller of the Treasury, *Secretary*
Riley C. Darnell, Secretary of State
Dale Sims, State Treasurer
Dave Goetz, Commissioner of Finance and Administration

STAFF

Mary-Margaret Collier, Director of Bond Finance, *Assistant Secretary*
Pat Haas, Bond Finance Manager

BOND COUNSEL TO THE STATE

Hawkins Delafield & Wood LLP, Attorneys at Law, New York, New York

FINANCIAL ADVISOR

Public Financial Management, Inc., Memphis, Tennessee

ISSUER'S COUNSEL

Attorney General and Reporter of the State of Tennessee, Nashville, Tennessee

This Official Statement does not constitute an offering of any security other than the Bonds offered hereby. No dealer, broker or other person has been authorized to give any information or to make any representation other than as contained in this Official Statement, and if given or made, such other information or representation must not be relied upon as having been authorized by the State. This Official Statement does not constitute an offer to sell or a solicitation of an offer to buy, nor shall there be any sale of the Bonds by any person in any jurisdiction in which it is unlawful to make such offer, solicitation or sale.

Certain information set forth herein has been provided by the State. Certain other information set forth herein has been obtained by the State from sources believed to be reliable, but it is not guaranteed as to accuracy or completeness. The information and expressions of opinion herein are subject to change without notice and neither the delivery of this Official Statement, nor any sale made hereunder implies that the information contained herein is correct as of any time subsequent to the date hereof.

The Underwriters have provided the following sentence for inclusion in this Official Statement. The Underwriters have reviewed the information in this Official Statement in accordance with, and as part of, their respective responsibilities to investors under the federal securities laws as applied to the facts and circumstances in this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

NO REGISTRATION STATEMENT RELATING TO THE BONDS HAS BEEN FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ("SEC") OR ANY STATE SECURITIES AGENCY. THE BONDS HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SEC OR ANY STATE SECURITIES AGENCY, NOR HAS THE SEC OR ANY STATE SECURITIES AGENCY PASSED UPON THE ACCURACY OR ADEQUACY OF THIS OFFICIAL STATEMENT. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

In making an investment decision, investors must rely on their own examination of the State and the terms of the offering, including the merits and risks involved.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS THAT STABILIZE OR MAINTAIN THE MARKET PRICES OF THE BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

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STATE OF TENNESSEE
\$215,165,000 GENERAL OBLIGATION BONDS, 2004 REFUNDING SERIES C

INTRODUCTION

This Official Statement, which includes the cover page and the inside cover page hereof, and the Appendices hereto, including the financial information incorporated by reference in Appendix A, is provided for the purpose of presenting information relating to the State of Tennessee (the “State”) in connection with the issuance of the State’s \$215,165,000 General Obligation Bonds, 2004 Refunding Series C (the “Bonds”).

The Bonds will be issued pursuant to the authority of and in full compliance with the provisions, restrictions and limitations of the Constitution and laws of the State, including Title 9, Chapter 9, Tennessee Code Annotated, and various bond authorizations enacted by the General Assembly of the State, and pursuant to a resolution adopted by the Funding Board of the State on April 15, 2004, as amended on August 12, 2004. The Bonds are being issued to refund certain of the State’s outstanding general obligation bonds (the “Refunded Bonds”) and to pay certain costs of issuance. (See “Plan of Refunding and Application of Bond Proceeds”).

The Bonds are direct general obligations of the State the payment of which as to both principal and interest the full faith and credit of the State are pledged. As additional security for the Bonds and the interest thereon, there is also pledged the annual proceeds of certain specific taxes, revenues and fees required to be paid to the State. The Bonds, together with interest thereon, are entitled to the benefit of these taxes, fees and revenues and to share therein pro rata with any other obligations of the State that might be entitled to share therein as provided by Title 9, Chapter 9, Tennessee Code Annotated. (See “Security for the Bonds”).

THE BONDS

Description

The Bonds will be dated August 15, 2004, will mature on September 1 of each of the years and in the principal amounts as shown on the inside cover page, and will bear interest payable semi-annually on March 1 and September 1 commencing March 1, 2005, at the rates per annum as shown on the inside cover page. The Bonds will be issuable as fully registered bonds in principal amounts of \$5,000 or integral multiples thereof.

The Bonds are not subject to redemption prior to maturity.

Book-Entry Only System

Upon initial issuance, the Bonds will be available only in book-entry form. The Depository Trust Company (“DTC”), New York, New York, will act as securities depository for the Bonds. The ownership of one fully registered Bond for each maturity of the Bonds bearing interest at each interest rate, each in the aggregate principal amount of such maturity bearing interest at such rate, will be registered in the name of Cede & Co. (DTC’s partnership nominee) and deposited with DTC. Beneficial owners of Bonds will not receive physical delivery of bond certificates, except under limited circumstances.

For a description of DTC and its book-entry only system, see “Appendix D – Book-Entry Only System”.

**PLAN OF REFUNDING AND
APPLICATION OF BOND PROCEEDS**

The Bonds are being issued to refund the series (or portions thereof) and maturities of general obligation bonds of the State (collectively, the “Refunded Bonds”) set forth below. The Refunded Bonds will be called for redemption on the respective redemption dates set forth below, at the respective redemption prices as stated below. Such designations for redemption will be irrevocable upon issuance of the Bonds.

Refunded Bonds

<u>Series</u>	<u>Maturity Date</u>	<u>Interest Rate</u>	<u>Principal Amount</u>	<u>Redemption Date</u>	<u>Redemption Price</u>
1996A	5/1/2008	4.600%	\$5,660,000	5/1/2006	100.00%
	5/1/2009	4.750%	5,660,000	5/1/2006	100.00
	5/1/2010	4.800%	5,660,000	5/1/2006	100.00
	5/1/2011	4.900%	5,660,000	5/1/2006	100.00
	5/1/2012	5.000%	5,660,000	5/1/2006	100.00
	5/1/2013	5.000%	5,660,000	5/1/2006	100.00
	5/1/2014	5.000%	5,660,000	5/1/2006	100.00
	5/1/2015	5.000%	5,660,000	5/1/2006	100.00
	5/1/2016	5.000%	5,660,000	5/1/2006	100.00
			<u>\$50,940,000</u>		
1997A	5/1/2011	5.125%	\$8,640,000	5/1/2007	101.50%
	5/1/2012	5.250%	8,640,000	5/1/2007	101.50
	5/1/2013	5.250%	8,640,000	5/1/2007	101.50
	5/1/2014	5.250%	8,640,000	5/1/2007	101.50
	5/1/2015	5.250%	8,640,000	5/1/2007	101.50
			<u>\$43,200,000</u>		
1998B	5/1/2010	5.000%	\$3,470,000	5/1/2008	100.00%
	5/1/2011	5.000%	3,475,000	5/1/2008	100.00
	5/1/2012	5.000%	3,470,000	5/1/2008	100.00
	5/1/2013	5.000%	3,470,000	5/1/2008	100.00
	5/1/2014	5.000%	3,470,000	5/1/2008	100.00
	5/1/2015	5.000%	3,475,000	5/1/2008	100.00
			<u>\$20,830,000</u>		
1999B	5/1/2011	4.875%	\$3,825,000	5/1/2009	100.00%
	5/1/2012	5.250%	3,825,000	5/1/2009	100.00
	5/1/2013	5.250%	3,825,000	5/1/2009	100.00
	5/1/2014	5.250%	3,825,000	5/1/2009	100.00
	5/1/2015	5.250%	3,825,000	5/1/2009	100.00
	5/1/2016	5.250%	3,825,000	5/1/2009	100.00
	5/1/2017	5.250%	3,825,000	5/1/2009	100.00
	5/1/2018	5.250%	3,825,000	5/1/2009	100.00
			<u>\$30,600,000</u>		
2000A	3/1/2011	5.000%	\$7,500,000	3/1/2010	100.00%
	3/1/2012	5.000%	7,500,000	3/1/2010	100.00
	3/1/2013	5.000%	7,500,000	3/1/2010	100.00
	3/1/2016	5.100%	7,500,000	3/1/2010	100.00
	3/1/2017	5.250%	7,500,000	3/1/2010	100.00
	3/1/2018	5.250%	7,500,000	3/1/2010	100.00
			<u>\$45,000,000</u>		
2002A	2/1/2013	5.000%	\$7,530,000	2/1/2012	100.00%
	2/1/2014	5.000%	7,530,000	2/1/2012	100.00
	2/1/2015	5.000%	7,530,000	2/1/2012	100.00
	2/1/2016	5.000%	7,530,000	2/1/2012	100.00
			<u>\$30,120,000</u>		
Total Refunded Bonds			<u>\$220,690,000</u>		

Written notice of any such redemption shall be mailed to the registered owners of the Bonds to be redeemed at least thirty (30) days before the redemption date. While DTC or its nominee is the registered owner of the Refunded Bonds, the State or the Refunding Trustee (described below) shall not be responsible for mailing notices of redemption to Direct DTC Participants or Indirect DTC Participants or to the Beneficial Owners of the Refunded Bonds.

The proceeds of the Bonds and other available monies will be used to acquire direct general obligations of or obligations the payment of principal of and interest on which are unconditionally guaranteed by the United States of America (the Government Obligations”) and to pay certain costs of issuance. The Government Obligations and the interest earned thereon will be sufficient, and will be used, together with other available monies, to pay (i) the principal of and redemption premiums, if any, on the Refunded Bonds on the respective redemption dates described above and (ii) the interest on the Refunded Bonds due on and prior to such redemption dates. The Government Obligations will be purchased from the Treasury Department of the United States of America or in the open market through a competitive bidding process. If such securities are purchased in the open market, they may be so purchased from the Underwriters of the Bonds.

Pursuant to the resolution authorizing the Bonds, Deutsche Bank National Trust Company has been appointed Refunding Trustee and will enter into a Refunding Trust Agreement with the State Funding Board. The Government Obligations and other available monies will be irrevocably deposited with the Refunding Trustee in a Refunding Trust Fund and irrevocably set aside for the benefit of the holders of the Refunded Bonds. The State will obtain verification of sufficiency of the Refunding Trust Fund and certain yields from McGladrey & Pullen LLP, a firm of independent certified public accountants. (See “Verification Agent”.)

Upon issuance of the Bonds, the Refunded Bonds to be redeemed prior to maturity will be irrevocably designated for redemption as described above, and provision will be made in the Refunding Trust Agreements for the giving of notice of such redemptions.

The refunding is being undertaken to realize debt service savings. Gross savings are \$18,733,866. Net present value debt service savings are \$11,554,698 based on a 3.5167% discount factor resulting in savings of 5.236% of the amount of the Refunded Bonds’ principal.

The proceeds of the Bonds and other available funds are expected to be applied on the date of issue of the Bonds in the estimated amounts as follows:

Sources and Uses of Funds

Sources of Funds:

Par Amount	\$215,165,000.00
Net Original Issue Premium.....	23,433,441.25
Accrued Interest.....	1,340,084.38
Other Available Funds.....	<u>275,000.00</u>
Total.....	<u>\$240,213,525.63</u>

Uses of Funds:

Deposit to Trust Fund for Refunded Bonds.....	\$238,048,931.91
Costs of Issuance.....	275,364.11
Underwriters’ Discount.....	549,145.23
Accrued Interest.....	<u>1,340,084.38</u>
Total.....	<u>\$240,213,525.63</u>

SECURITY FOR THE BONDS

All general obligation bonds of the State, including the Bonds, are and will be direct general obligations of the State, payable as to both principal and interest from any funds or monies of the State from whatever source derived. The full faith and credit of the State is pledged to the payment of principal of and interest on all general obligation bonds. As additional security to support its general obligation bonds, including the Bonds and tax revenue anticipation notes, the State, pursuant to Section 9-9-103, Tennessee Code Annotated, has pledged (i) the annual proceeds of a tax of up to five cents per gallon upon gasoline; (ii) the annual proceeds of a special tax of one cent (1¢) per gallon on petroleum products; (iii) one-half of the annual proceeds of motor vehicle registration fees now or hereafter required to be paid to the State; and (iv) the annual proceeds of the franchise taxes imposed by the franchise tax law of the State (collectively, "Special Taxes"). All general obligation bonds and tax revenue anticipation notes share this pledge of Special Taxes on a pro rata basis.

The Special Taxes collected for the last three fiscal years, as reported for each year in the June monthly Statement of Revenue Collections (prepared on a cash basis), were as follows (amounts have been rounded):

	Fiscal Year Ended		
	<u>June 30, 2004</u>	<u>June 30, 2003</u>	<u>June 30, 2002</u>
Gasoline Tax	\$150,647,000	\$149,583,000	\$144,722,000
Special Petroleum Tax	44,954,000	43,752,000	44,081,000
One-half of Motor Vehicle Registration Fees	114,875,000	108,822,000	105,816,000
Franchise Taxes	<u>506,776,000</u>	<u>489,579,000</u>	<u>420,768,000</u>
Total	<u>\$817,252,000</u>	<u>\$791,736,000</u>	<u>\$715,387,000</u>

Source: Department of Revenue

Pursuant to Section 9-9-106, Tennessee Code Annotated, the Funding Board has a lien on the taxes, fees and revenues from the Special Taxes in the full amount required to pay principal of and interest on the State's general obligation bonds and tax revenue anticipation notes issued under Title 9, Chapter 9, Tennessee Code Annotated. Pursuant to Section 9-9-111, Tennessee Code Annotated, the State has covenanted not to decrease by legislative action the Special Taxes unless the Funding Board certifies that the State is not in default in the payment of any outstanding debt and that Special Taxes at lower rates specified by the Funding Board in such year or years (not to exceed two (2) years) will be sufficient to make all payments required to be made therefrom by the State on all of its obligations during the period that such decrease will be in effect.

The principal amount of general obligation bonds and tax revenue anticipation notes that the State may issue is limited by Section 9-9-104, Tennessee Code Annotated, which provides in part as follows:

[N]o bonds or other obligations will be made a charge upon the special revenues consisting of the proceeds of the gasoline tax, franchise tax, the special tax on petroleum products provided for by Section 67-3-1303 and motor vehicle registration fees pledged under the provisions of this chapter, in addition to the obligations and charges authorized by this chapter, unless the revenues pledged by Section 9-9-103 or the aggregate of the pledged gasoline tax, the special tax on petroleum products provided for by Section 67-3-1303, motor vehicle registration fees and one-third of the entire annual proceeds of franchise and excise taxes imposed by the franchise and excise tax laws compiled in Title 67, Chapter 4, parts 9 and 8 (now parts 21 and 20), whichever sum is lower, for the last preceding fiscal year shall have aggregated not less than one hundred and fifty percent (150%) of the amount necessary to pay the annual interest upon all outstanding obligations and charges, for the payment of which such revenues are pledged, and the annual interest upon the obligations then proposed to be issued, together with the annual amount necessary for the amortization of said outstanding obligations and charges and the obligations then proposed to be issued; provided, however, in determining said outstanding obligations and charges there shall be excluded any outstanding bonds with respect to which refunding bonds have been issued and sold and the proceeds of which are to be applied to retire said outstanding bonds.

The amount of Special Taxes collected for the fiscal year ended June 30, 2004 was \$817,252,000. The aggregate of the pledged gasoline tax, the special tax on petroleum products, motor vehicle registration fees and one-third of the entire annual proceeds of franchise and excise taxes collected for the fiscal year ended June 30, 2004 was \$711,001,000. Pursuant to Section 9-9-104, Tennessee Code Annotated, the debt service limit is obtained by dividing the lesser amount (\$711,001,000) by one-

point-five (1.5). Therefore, the debt service limit for the fiscal year ending June 30, 2005 is \$474,000,667. The greatest amount of principal and interest payable in any fiscal year on outstanding bonds for the payment, of which Special Taxes have been pledged, including the Bonds and excluding the Refunded Bonds and the State's general obligation commercial paper ("CP"), is not more than \$149,713,562. This calculation assumes the 2004 Series B Bonds bear interest throughout their term at their current rate of 4.82%, but the result would not change if they bore interest at their maximum rate of 12% after March 1, 2010. (See "State Indebtedness – Outstanding General Obligation Bonded Indebtedness".)

Section 67-6-103(a)(5), Tennessee Code Annotated, currently provides that 0.9185% of the sales and use tax collections is appropriated to the Funding Board for the payment of principal of and interest on the State's general obligation bonds, but not tax revenue anticipation notes. This statutory provision subsequently may be changed or eliminated. The total sales and use tax collections and the amounts allocated to debt service for the last three fiscal years as reported in the State's Annual Financial Reports (prepared on a modified accrual basis) were as follows:

	<u>Total Collections</u>	<u>Allocation to Debt Service</u>
June 30, 2003	\$5,459,444,000	\$39,069,000
June 30, 2002	\$4,647,768,000	\$38,449,000
June 30, 2001	\$4,643,337,000	\$38,480,000

For a discussion of projected current year collections, see "State Finances – Financial Information and Budget Summary for Fiscal Years 2003-2004 and 2004-2005".

All general obligation indebtedness of the State is on parity and shares pro rata with all other general obligation indebtedness of the State, except that the Special Taxes secure only general obligation bonds and tax revenue anticipation notes. The State is permitted by the State Constitution to levy ad valorem taxes on all of the taxable property within the State for the payment of the principal of and interest on the State's general obligation indebtedness; however, the State does not currently levy such a tax.

For a table of annual debt service requirements for all general obligation bonds, excluding the Bonds, see "State Indebtedness – Outstanding General Obligation Bonded Indebtedness". In addition, the State may issue, and currently is issuing as CP, general obligation bond anticipation notes for the payment of which the full faith and credit of the State, but not Special Taxes, is pledged. (See "State Indebtedness – Commercial Paper Program".) In addition, the State is authorized to issue general obligation tax revenue anticipation notes for the payment of which the full faith and credit of the State, and Special Taxes, are pledged. (See "State Indebtedness – Tax Revenue Anticipation Notes".)

Remedies and Rights of Bondholders

Each Bond when duly issued will constitute a contract between the State and the registered owner of the Bond. If the State defaults in payment of any State obligation to which Special Taxes are pledged and/or other fees and taxes are pledged for this purpose, State law requires the State Treasurer or other appropriate authority to pay the amount required for the payment of such obligations out of the first monies received from such taxes and fees. Under State law, a holder or purchaser of any such obligation, including the Bonds, has a vested right in the performance of the covenants and pledges made by the State in the issuance of such obligations and may enforce by appropriate proceedings such covenants, pledges, and duties imposed on any State agency or officer in connection with the issuance of such obligations. The State has not generally waived immunity from suit or extended its consent to be sued and this may bar actions against such agencies and officers. Current State law provides that monetary claims against the State for breach of its contractual obligations and certain other causes may be heard and determined exclusively in the forum of the Tennessee Claims Commission, an administrative tribunal, where the State may be liable only for actual damages and certain costs.

Under the State Constitution, public money may be expended only pursuant to appropriations made by law. (See "State Finances.") Such expenditures include, but are not limited to, the payment of debt service and funding any judgment in the Tennessee Claims Commission. Continuing appropriations exist for the payment of debt service on the State's general obligation bonds, including the Bonds, from Special Taxes, in connection with the pledge of Special Taxes in Title 9, Chapter 9, Tennessee Code Annotated, and under current law, from a specified percentage of sales and use taxes as discussed above. Furthermore, 2001 Pub Ch. 264 amends Section 9-9-103, Tennessee Code Annotated, by appropriating to the State Funding Board on a direct

and continuing basis a sum sufficient for payment of debt service (principal, interest and premium, if any) on outstanding general obligation bonds and other debt obligations (including notes) from any funds held in the State treasury not otherwise legally restricted, independent of an appropriation bill otherwise required by State law. Whether a continuing appropriation exists for the payment of a claim in the Tennessee Claims Commission for unpaid debt service is not clear, and in any event sovereign immunity and other legal principles may bar actions to compel the General Assembly to appropriate monies for such payments.

STATE INDEBTEDNESS

General

The State Constitution forbids the expenditure of the proceeds of any debt obligation for a purpose other than the purpose for which it was authorized. Under State law, the term of bonds authorized and issued cannot exceed the expected life of the projects being financed. Furthermore, the amount of bonds issued cannot exceed the amount authorized by the General Assembly.

The procedure for funding State debt is provided by Chapter 9 of Title 9, Tennessee Code Annotated. The Funding Board of the State of Tennessee is the entity authorized to issue general obligation indebtedness of the State. The Funding Board is composed of the Governor, the State Comptroller of the Treasury, the Secretary of State, the State Treasurer, and the Commissioner of Finance and Administration. The Funding Board issues all general obligation indebtedness in the name of the State pursuant to authorization by the General Assembly without concurrence or approval by any other governmental agency or by the electorate. Although the Funding Board determines the terms of general obligation indebtedness, the interest rate on the general obligation indebtedness cannot exceed the State Formula Rate which is set forth in Section 47-14-103, Tennessee Code Annotated.

Bonds by Purpose

State law provides that the State may issue general obligation bonds or notes for one or more purposes, whether or not the purposes were authorized in the same legislative act. As of July 31, 2004, the State had \$1,143,295,000 (unaudited) of general obligation bonds outstanding, of which \$8,020,000 was for public health loans, and the remaining \$1,135,275,000 was for general governmental purposes. The bonds for the public health loans were initially issued in the amount of \$85,195,000 to fund loans to local government units to aid in constructing and improving sewage treatment works, waterworks construction, and solid waste resource recovery facilities. State law requires local governments receiving loans to repay the State through scheduled repayments sufficient to pay indebtedness incurred by the State to finance such loans. Consequently, it is not anticipated that any State tax revenues will be required to meet the principal of or interest on the public health loan bonds. Since 1978, public health loans have been funded through the issuance of revenue bonds and notes by the Tennessee Local Development Authority. (See “Debt of Certain Agencies and Authorities – The Tennessee Local Development Authority”).

Commercial Paper Program

Bond anticipation notes may be issued for purposes for which bonds have been authorized, if the notes are also authorized by legislative act. Notes have been authorized to be issued for the purposes of all existing bond authorizations.

In March 2000, the State instituted a general obligation commercial paper program (the CP) for authorized capital projects. CP will be issued under the Commercial Paper Resolution, adopted by the members of the Funding Board of the State on March 6, 2000, in a principal amount outstanding at any one time not to exceed \$250,000,000. The CP constitute Notes and are direct general obligations of the State for the payment of which, as to both principal and interest, the full faith and credit of the State, but not Special Taxes, are pledged.

The State has entered into a Standby Commercial Paper Purchase Agreement with the Tennessee Consolidated Retirement System (“TCRS”) under which TCRS is obligated to purchase newly issued CP issued to pay the principal of other CP, subject to suspension or termination upon the occurrence of certain events. If and for so long as TCRS is the Standby Purchaser, the principal amount of CP maturing on any day shall not exceed \$100,000,000 or such greater principal amount as it may agree to.

The CP will have varying maturities of not more than 270 days from their respective dates of issuance; provided, however, that no CP may mature later than the sixth business day prior to the stated expiration date without regard to any early termination of the Liquidity Facility. Currently, this date is April 1, 2010. CP is not subject to redemption prior to maturity.

As of July 31, 2004, \$82,775,000 (unaudited) principal amount of CP was outstanding under this program.

Tax Revenue Anticipation Notes

The State is authorized to issue general obligation tax revenue anticipation notes ("TRANS") in anticipation of the receipt of tax revenues in the then current fiscal year of the State. TRANS, if issued, will constitute direct obligations of the State for the payment of which, as to both principal and interest, the full faith and credit of the State, and also Special Taxes, are pledged. All TRANS must be redeemed in the same fiscal year in which they are issued. The State has not heretofore issued TRANS.

Outstanding General Obligation Bonded Indebtedness

As of July 31, 2004, there were \$1,143,295,000 (unaudited) State general obligation bonds outstanding, excluding the Bonds.

The annual debt service requirements for the outstanding long-term general obligation bonded indebtedness (including the Bonds and excluding the Refunded Bonds) are as follows:

Fiscal				Fiscal			
Year	Principal	Interest *	Total	Year	Principal	Interest *	Total
2005	\$98,890,000	\$50,823,562	\$149,713,562	2018	\$39,560,000	\$8,272,519	\$47,832,519
2006	96,940,000	51,275,364	148,215,364	2019	30,560,000	6,559,240	37,119,240
2007	85,975,000	46,370,654	132,345,654	2020	26,785,000	5,004,158	31,789,158
2008	80,150,000	42,151,492	122,301,492	2021	19,405,000	3,645,700	23,050,700
2009	79,695,000	38,415,847	118,110,847	2022	19,535,000	2,679,250	22,214,250
2010	77,060,000	34,528,849	111,588,849	2023	11,460,000	1,705,910	13,165,910
2011	75,565,000	30,236,382	105,801,382	2024	11,485,000	1,149,824	12,634,824
2012	71,835,000	26,476,368	98,311,368	2025	3,140,000	797,504	3,937,504
2013	71,860,000	22,714,418	94,574,418	2026	3,295,000	646,051	3,941,051
2014	65,860,000	19,268,793	85,128,793	2027	3,245,000	492,122	3,737,122
2015	57,850,000	15,894,851	73,744,851	2028	3,400,000	335,713	3,735,713
2016	52,950,000	13,036,661	65,986,661	2029	<u>3,565,000</u>	<u>171,833</u>	<u>3,736,833</u>
2017	47,705,000	10,669,190	58,374,190				
				Totals	<u>\$1,137,770,000</u>	<u>\$433,322,255</u>	<u>\$1,571,092,255</u>

* The 2004 Series B Bonds, which mature March 1, 2013 through 2029, bear interest at the rate of 4.82% to March 1, 2010, and thereafter at rates to be determined but not to exceed 12%. For purposes of this schedule, the interest on 2004 Series B Bonds is calculated using 4.82% through 2029 in accordance with GASB 38, which states that interest requirements for variable rate debt should be determined using the rate in effect at the financial statement date.

The State had authorized, as of July 31, 2004, \$1,570,953,899 (unaudited) of general obligation bonds that had not been issued. Of this amount \$800,500,000 is for highway projects and not expected to be issued. Since 1978 highway construction has been funded with current revenue.

STATE FINANCES

The Budget Process

The State budget originates in the executive branch with the Governor's annual budget recommendation to the General Assembly. Initially, budget preparation instructions are issued by the Department of Finance and Administration to all State agencies and departments. These instructions describe the Administration's guidelines related to continuing the current level of service (baseline budget) and proposed budget improvements. The instructions are to be used by agencies and departments in preparing their budgets for submission to the Department of Finance and Administration in October of each year.

During the fall, each department's budget request is reviewed, and improvement requests are analyzed by the Department of Finance and Administration. Conferences are held with departmental and agency representatives, the Director of Budget, and the Department of Finance and Administration staff to determine which, if any, of the proposals should be recommended.

Under State law, the Governor submits the recommended budget to the General Assembly at the start of the legislative session. The budget document must be presented to the General Assembly prior to February 1 of each year, except that a Governor in the first year of a four-year term of office must present a budget prior to March 1 of that year. However, the General Assembly may extend these deadlines by joint resolution. Subsequently, the Governor submits a General Appropriation Bill and bond authorization bills containing appropriations and general obligation bond authorizations required to finance the program levels and capital outlay proposed in the Governor's budget. Throughout the legislative session, the Finance, Ways and Means Committees and appropriate standing committees of the House and Senate hold budget hearings for each department to determine if changes should be made to the proposals.

During the 1997 legislative session, the Office of Legislative Budget Analysis was created to enable the General Assembly to strengthen its expertise in governmental budgeting and financing and in making public policy decisions. The office was created as an independent department of the legislature working for both the Senate and the House of Representatives and charged with reviewing and analyzing the State's budget and overall financial condition. The staff summarizes and analyzes the Governor's budget proposal for members of the General Assembly, secures budget justification data from the various state agencies, provides recommendations on budget proposals and provides assistance on financial matters to the standing committees, as directed.

Under the State Constitution, money may be drawn from the Treasury only through an appropriation made by law. The primary source of the annual expenditure authorization is the General Appropriation Act as approved by the General Assembly and signed by the Governor. These appropriations are generally limited to a one-year period of availability. The General Appropriation Act requires a simple majority vote of each House of the General Assembly. Approval of the General Appropriation Bill usually occurs during the last week of the legislative session. Once signed by the speaker of each House of the General Assembly, the General Appropriation Act is sent to the Governor for signature. If the Governor does not act within ten days, excluding Sundays, the General Appropriation Act becomes law without signature. The Governor may reduce or eliminate specific line items in the General Appropriation Act or any other appropriations bill without vetoing the entire bill. Such individual line-item vetoes are subject to override by a vote of a majority of the members elected to each House of the General Assembly.

Appropriations also may be included in legislation other than the General Appropriation Act. The individual bills containing appropriations must be heard by the Finance, Ways and Means Committee, and may be heard by the relevant standing committee, in each House of the General Assembly. After all related committees recommend passage, bills containing appropriations must be approved by a majority vote in each House of the General Assembly and be acted upon by the Governor. Bills of this character are also subject to reduction or elimination by individual line-item veto by the Governor and override by the General Assembly, as described above.

Funds necessary to meet an appropriation need not be in the Treasury at the time such appropriation is enacted; revenues may be appropriated in anticipation of their receipt.

Development of Revenue Estimates

The development of the general fund revenue estimates begins with a forecast of national economic activity for the State budget period. The State currently contracts with The University of Tennessee Center for Business and Economic Research ("UT-CBER") to prepare an annual Economic Report to the Governor containing short-term business cycle-sensitive forecasts as well as longer-term or trend forecasts for the year and to prepare quarterly updates throughout the year. UT-CBER subscribes to the macroeconomic forecasting services of Wharton Econometric Forecasting Associates. The Wharton National Economic Forecast becomes the principal input to the Tennessee Econometric Model which is utilized to develop a forecast of similar indicators of in-state activity.

At least annually, the Funding Board secures from UT-CBER the estimated rate of growth of the State's economy as measured by the forecast change in Tennessee personal income. The Funding Board reviews the estimated rate of growth in

Tennessee personal income and reports to the General Assembly its comments relating to the reasonableness of the estimate, including any different estimate deemed necessary.

The Funding Board is further directed by statute to conduct public hearings to develop consensus ranges of estimates of State revenue for the current fiscal year and the next succeeding fiscal year. At the hearings representatives of state higher education institution business centers, including UT-CBER, present revenue estimates and economic forecasts. On December 1, or as soon thereafter as practical, the Funding Board presents its consensus ranges of State revenue estimates, and a summary of the economic forecast on which the estimates are based, to the Governor and the Chairs of the Senate and House Finance, Ways and Means Committees. Although not mandated prior to final legislative action on the budget, the Funding Board receives updated estimates and forecasts at public hearings in the spring and forwards any revision to prior estimates and the reasons therefor to the Governor and Chairs. The Commissioner of Finance and Administration has the responsibility for preparing the revenue estimates presented in the budget document.

Reserve for Revenue Fluctuations

In 1996, the General Assembly enacted legislation determining the allocation goal for the reserve to be five percent of estimated State tax revenues to be allocated to the general fund and education trust fund. Beginning with the budget for the fiscal year 1998-99 and until this funding level is achieved, the Governor is to budget an allocation to the reserve in an amount at least equal to ten percent of the estimated growth in estimated State tax revenues to be allocated to the general fund and education trust fund. Amounts in the revenue fluctuation reserve may be utilized to meet State tax revenue shortfalls. An amount not to exceed the greater of \$100 million or one-half of the amount in the reserve may be utilized to meet expenditure requirements in excess of budgeted appropriation levels. Use of the reserve for expenditure requirements requires prior notice to and meetings of the Senate and House Finance, Ways and Means Committees. The reserve amount was established as \$101.4 million for fiscal years 1993-94 through 1997-98. It was increased to \$127 million for fiscal year 1998-99, to \$165.1 for fiscal year 1999-2000, and to \$178 million on June 30, 2001, on June 30, 2002 and on June 30, 2003. The Appropriations Act, as amended, increased the reserve fund to \$217 million on June 30, 2004. The reserve fund is budgeted to increase to \$273.4 million at June 30, 2005. See "State Finances - Financial Information and Budget Summary for Fiscal Years 2003-2004 and 2004-2005" for a discussion of possible utilization of this fund in the current and next fiscal years.

Financial Control Procedures

The State Constitution requires, for current operations, expenditures for any fiscal year not to exceed the State's revenues and reserves, including the proceeds of any debt obligation, for that year. The State Constitution prohibits the issuance of debt for operating purposes maturing beyond the end of a fiscal year. State law permits tax anticipation borrowing but any amount borrowed must be repaid by the end of the fiscal year.

Generally, the executive branch controls the expenditure of State funds for the operation of State government. Two important concepts are involved in the execution of the General Appropriation Act: preparation of work programs and development of allotment controls. Analysts of the Division of Budget, Department of Finance and Administration, and fiscal personnel in the various State departments and agencies have the responsibility of reconciling the General Appropriation Act, as approved, with the submitted budget. State law requires that administrative agencies prepare a work program for each fiscal year. These work programs indicate separate annual spending requirements for payroll and other operating expenses necessary to carry out agency programs. The head of any agency may revise the work program during the fiscal year because of changed conditions and submit such revision for approval. If the Commissioner of Finance and Administration and the Governor approve the revision, then the same procedure for review, approval and control is followed as in making the original allotments. The aggregate of all allotments after the revision cannot exceed the total appropriations made to the agency for the fiscal year in question.

All expenditures of State administrative agencies are processed through the Department of Finance and Administration and are measured against work program allotments. Savings which may occur as a result of the difference between the amounts provided in the work program allotments for payroll and other operating expenditures and the amounts actually spent for those expenditures accumulate throughout the fiscal year unless a work program is revised to re-allot unspent amounts. Likewise, departmental revenue surpluses cannot be spent until approved by the Commissioner of Finance and Administration and, in some cases, reviewed by the Finance, Ways and Means Committees of the General Assembly. Such central spending control offers executive flexibility relative to any anticipated surplus or shortfall in the budget.

The Governor may effect spending reductions to offset unforeseen revenue shortfalls or unanticipated expenditure requirements for particular programs. These spending reductions can take the form of deferred equipment purchases, hiring freezes, and similar cutbacks. If necessary, the Governor may reduce portions of administrative budgets prior to allotment. Furthermore, the Governor is authorized to call special sessions of the General Assembly at any time to address financial or other emergencies.

Financial Information and Budget Summary for Fiscal Years 2003-2004 and 2004-2005

Financial Information

The General Assembly approved an annual appropriations act on May 29, 2003 for fiscal year 2003-2004. The 2003-2004 budget is balanced with recurring revenue supporting recurring expenditures.

On an accrual basis, current revenue exceeds budgeted estimates. For the twelve months ending July 31, 2004, the State's General Fund is \$353.5 million over budgeted estimates and the four other funds (the Highway Fund, Sinking Fund, City and County Fund and Earmarked Fund) are over budgeted estimates by \$26.8 million. Therefore, overall revenues are \$380.3 million over budgeted estimates. All numbers are unaudited.

The General Assembly passed, and on June 15, 2004 the Governor signed, the Appropriations Bill for the fiscal year 2004-2005 budget. The 2004-2005 budget, as passed by the General Assembly and signed by the Governor, is balanced with recurring revenues supporting recurring expenditures.

Revenue Growth

At the State Funding Board meeting held on April 19, 2004 the Board made the following consensus revenue growth projections:

	Fiscal Year 2003-2004		Fiscal Year 2004-2005	
	<u>Low</u>	<u>High</u>	<u>Low</u>	<u>High</u>
Total State Taxes	5.50%	6.05%	3.60%	4.35%
General Fund Only	6.60%	7.35%	3.85%	4.60%

[Remainder of page intentionally left blank. Official Statement continues on following page.]

Budget Summary

The following tables compare sources and uses of funds for fiscal years 2003-2004 and 2004-2005:

Sources of Funds As of July 9, 2004			
	Estimated Budget FY 2003-2004	Estimated Budget FY 2004-2005	Difference
Tax Revenue			
Sales and Use Taxes	\$ 5,787,300,000	\$ 6,096,600,000	\$ 309,300,000
Other Taxes	3,220,800,000	3,298,900,000	78,100,000
Other Miscellaneous Revenues	837,231,800	849,755,600	12,523,800
Federal Funds	8,700,000,000	9,356,783,000	656,783,000
Current Services and Other Revenues	2,750,000,000	2,871,328,000	121,328,000
Tuition and Student Fees	745,000,000	789,520,000	44,520,000
Bonds	90,500,000	493,880,000	403,380,000
Tobacco Funds	153,200,000	147,800,000	(5,400,000)
Local Government Funds	49,800,000	49,800,000	-
Federal Essential Services Funds	139,632,600	-	(139,632,600)
Adjustment for Interfund Transfers	53,500,000	-	(53,500,000)
Reserve Transfers	(322,564,400)	352,890,400	675,454,800
Reversions - Underexpenditures	104,600,000	104,600,000	-
Rainy Day Fund Transfer	(39,000,000)	(58,400,000)	(19,400,000)
Total	\$ 22,270,000,000	\$ 24,353,457,000	\$ 2,083,457,000

**Uses of Funds
As of July 9, 2004**

Program	Estimated Budget FY 2003-2004	Estimated Budget FY 2004-2005	Difference
General Government	\$ 654,736,000	\$ 920,787,000	\$ 266,051,000
Education	6,020,009,000	6,331,350,000	311,341,000
Health and Social Services	10,828,350,000	11,721,844,000	893,494,000
Law, Safety, and Correction	1,157,161,000	1,175,581,000	18,420,000
Resources and Regulation	687,864,000	673,344,000	(14,520,000)
Business and Economic Development	434,087,000	453,926,000	19,839,000
Total General Fund	19,782,207,000	21,276,832,000	1,494,625,000
Transportation	1,443,590,000	1,619,845,000	176,255,000
Debt Service Requirements	228,163,000	250,800,000	22,637,000
Capital Outlay Program	70,232,000	398,540,000	328,308,000
Facilities Revolving Fund	99,608,000	136,240,000	36,632,000
Cities and Counties - State Shared Taxes	646,200,000	671,200,000	25,000,000
Total State Budget All Programs	\$ 22,270,000,000	\$ 24,353,457,000	\$ 2,083,457,000

Investment Policy

The Funding Board is charged with the establishment of the investment policy for the State. The State Treasurer is responsible for the management of the State Pooled Investment Fund (which includes the State's cash, various dedicated reserves and trust funds of the State, and the Local Government Investment Pool). The primary investment objective for the State Pooled Investment Fund is safety of principal, followed by liquidity and yield. No investments may be purchased with a remaining maturity of greater than 397 calendar days however, the weighted average maturity cannot exceed 90 days. Funds may be invested in collateralized certificates of deposit with authorized Tennessee financial institutions; bills, notes, and bonds of the U.S. Treasury; other obligations guaranteed as to principal and interest by the United States or any of its agencies; and repurchase agreements against obligations of the United States or its agencies. Securities underlying repurchase agreements must be direct obligations of the United States Government or other obligations guaranteed as to principal and interest by the United States or any of its agencies and held by the Federal Reserve Bank in the account of the State Trust of Tennessee or by a trustee-custodian under a tri-party contract between the Treasury Department, the broker-dealer, and the custodian bank. Funds may also be invested in prime commercial paper, prime banker's acceptances, certain securities lending agreements, and certain obligations of the State, pursuant to Section 9-4-602 (b), Tennessee Code Annotated. The State Trust of Tennessee, a non-profit corporation established in 1979, is a limited member of the Federal Reserve Bank System. (See Note 5 A. "Deposits and investments" to the financial statements of the State; see Appendix A.)

GASB 34

The Governmental Accounting Standards Board imposed significant new accounting standards on state and local governments pursuant to Statement No. 34 ("GASB 34"). GASB 34 was effective commencing in fiscal year 2001-02 for state and local governments with over \$100 million in revenues. GASB 34 imposes several new requirements with respect to the financial statements prepared by state and local governments, including: (i) a requirement of detailed financial statements for any major fund (defined as a fund whose revenues, expenses, assets or liabilities are at least 10% of the corresponding totals for all government or enterprise funds and at least 5% of the aggregate amount for all government and enterprise funds); (ii) a budget analysis with a comparison to the original budget (as opposed to including only a comparison with the budget that has been revised throughout the course of the year); (iii) a required reporting of all capital assets, including infrastructure such as roads and bridges; and (iv) preparation of a management discussion and analysis letter (the "MD&A") for the purpose of providing an analytic overview of the government's financial activities, including an analysis of any significant changes in capital assets or long-term debt. The modified approach for infrastructure assets is used by the State. This means that infrastructure assets, and additions and improvements which increase the capacity or efficiency of these assets, will be capitalized but not depreciated, and expenditures made to preserve their useful life will be expensed and not depreciated.

Financial Reporting and Budgeting Awards

The Government Finance Officers Association of the United States and Canada (the "GFOA") has awarded Certificates of Achievement for Excellence in Financial Reporting both to the State of Tennessee for its comprehensive annual financial report every year since the fiscal year ended June 30, 1979 and to the Tennessee Consolidated Retirement System for its financial report every year since the fiscal year ended June 30, 1988. In order to be awarded a Certificate of Achievement for Excellence, a governmental unit must publish an easily readable and efficiently organized comprehensive annual financial report, the content of which conforms to program standards. Such reports must satisfy both generally accepted accounting principles and applicable legal requirements.

The GFOA also presented its Distinguished Budget Presentation Award to the State for its annual budget for the fiscal years ended June 30, 1992 through June 30, 1995 and June 30, 1998 through June 30, 2004. In order to receive this award, a governmental unit must publish a budget document that meets program criteria as a policy document, as an operations guide, as a financial plan and as a communication device.

DEBT OF CERTAIN AGENCIES AND AUTHORITIES

The following entities are the corporate governmental agencies and instrumentalities of the State authorized to issue various debt instruments. The State is not liable on any debt instrument issued by any of the following entities, and no such debt instrument is a debt or obligation of the State and the full faith and credit of the State is not pledged to the payment thereof.

The Tennessee Local Development Authority

In 1978, the General Assembly created the Tennessee Local Development Authority (the "TLDA") [Sections 4-31-101 et seq., Tennessee Code Annotated]. TLDA is authorized to loan funds to local governments for sewage treatment, waterworks, capital projects, fire fighting equipment, and airport facilities; and is authorized to loan funds to certain small business concerns for pollution control equipment. TLDA also is authorized to make funds available for loans for agricultural enterprises. TLDA is authorized to make loans to not-for-profit organizations providing certain mental health, mental retardation, and alcohol and drug services. TLDA is a corporate governmental agency and instrumentality of the State. In order to fund these loans, TLDA is empowered to issue bonds and notes in aggregate amounts outstanding not to exceed the following: \$302,805,000 for sewage treatment and waterworks facilities; \$10,000,000 for firefighting equipment; \$200,000,000 for airport facilities; \$50,000,000 for pollution control equipment; \$50,000,000 for capital projects; \$50,000,000 for mental health, mental retardation, and alcohol and drug services; and \$30,000,000 for agricultural enterprises.

Bonds and notes issued by TLDA are secured by: (i) in the case of loans to local governments, monies received by TLDA under loan program agreements with the local governments and by the local government's allocation of state-shared taxes; (ii) in the case of loans to small business concerns, the monies received under agreements with those concerns; (iii) in the case of loans to not-for-profit organizations, monies received under State grant agreements and a pledge of the department of mental

health and mental retardation's annual budget; and (iv) in the case of agricultural loans, the monies received under agreements with lenders and a pledge of any money, income or revenue from any source.

As of July 31, 2004, TLDA had \$34,465,000 (unaudited) of bonds and \$47,500,000 (unaudited) of bond anticipation notes outstanding for the making of loans for sewage treatment and waterworks facilities.

The Tennessee State School Bond Authority

In 1965, the General Assembly created the Tennessee State School Bond Authority (the "Authority") [Sections 49-3-1201 et seq., Tennessee Code Annotated]. The Authority is a corporate governmental agency and instrumentality of the State of Tennessee. The Authority is authorized to issue its bonds and notes to finance capital outlay programs for higher educational facilities which may be required or convenient for the purposes of The University of Tennessee, including its branches and divisions, and for the purposes of the institutions of higher education under the supervision and administration of the Tennessee Board of Regents of the State University and Community College System of the State of Tennessee. In 1980, the General Assembly further authorized the Authority to issue its bonds or notes to provide funds for the making of student loans by the Tennessee Student Assistance Corporation; however, no such bonds or notes have been issued for this purpose. The Authority also is authorized to issue Qualified Zone Academy Bonds ("QZAB") to finance improvement loans to cities and counties for qualifying K-12 schools.

Generally, all outstanding higher educational facility debt obligations of the Authority are secured by financing charges payable under contracts and agreements entered into by the Authority and the Board of Trustees of The University of Tennessee and the Tennessee Board of Regents of the State University and Community College System of the State of Tennessee, as successor to the State Board of Education; legislative appropriations; and certain funds and accounts established by the Higher Educational Facilities General Bond Resolutions of the Authority. The QZAB bonds are part of a Federal government program in which a Federal income tax credit is given to investors in lieu of interest on the bonds and are secured by the general obligation pledge of the borrowers and the unobligated state-shared taxes of the borrowers.

As of July 31, 2004, the Authority had outstanding \$504,147,024 (unaudited) aggregate principal amount of higher educational facility bonds (including accretion of College Savings Bonds), had outstanding \$32,156,000 (unaudited) of higher educational facility commercial paper, and had outstanding \$27,065,000 (unaudited) aggregate principal amount of QZAB bonds. It is the intention of the Authority to issue an additional \$13,180,000 of QZABs in September 2004.

The Tennessee Housing Development Agency

In 1973, the General Assembly created the Tennessee Housing Development Agency (the "Agency"), [Sections 13-23-101 et seq., Tennessee Code Annotated (the "Tennessee Housing Development Agency Act")]. The Agency is authorized, among other things, to issue its bonds and notes to make funds available for the financing of decent, safe and sanitary residential housing for persons and families of lower and moderate income and to assist in coordinating Federal, state, regional and local public and private efforts and resources to increase the supply of residential housing.

The Agency has established a mortgage finance program and is making funds available for loans for residential housing for persons or families of lower and moderate income. Such loans are secured by eligible mortgages on the properties. The Agency has made, but does not currently make, loans for multi-family residential housing for rental occupancy.

In order to accomplish its objectives, the General Assembly has authorized the Agency to issue its bonds and notes, provided that the aggregate principal amount outstanding on such bonds and notes may not exceed \$2,050,000,000, excluding bonds and notes which have been refunded. The Agency's net indebtedness, excluding the refunded bonds, at August 1, 2004, was \$1,791,581,349 (unaudited).

Obligations of the Agency are secured by, among other things, mortgage loans made by the Agency from the proceeds of such obligations. The Tennessee Housing Development Agency Act provides a mechanism for certifying to the Governor and to the Commissioner of Finance and Administration amounts, if any, needed for debt service or operating expenses of the Agency and authorizes the General Assembly to appropriate, to expend and to provide for the payment of such amounts, but imposes no legal obligation upon the General Assembly to do so. These provisions of the Tennessee Housing Development Agency Act do not constitute a legally enforceable obligation of the State to pay any such amounts. Under the Constitution of the State, no monies may be withdrawn from the Treasury but in consequence of appropriations made by law.

Watkins Institute

Watkins Institute (the "Institute") is an educational institution located in Nashville. Since 1881, the State has served as trustee of a trust providing for the maintenance of the Institute. On behalf of the State as trustee and with the approval of the State Senate, the Governor of the State appoints commissioners of the Institute, all as provided in the wills and codicils establishing the trust. In 1956, the Chancery Court of Davidson County determined that the Institute was a State agency for the purpose of providing capital improvements through the issuance of bonds. No such bonds have been issued.

State Veterans' Homes Board

In 1988, the General Assembly created the Tennessee State Veterans' Homes Board (the "Veterans' Homes Board") [Sections 58-7-101 to 58-7-112, inclusive, Tennessee Code Annotated]. A political subdivision and instrumentality of the State, the Veterans' Home Board is authorized to issue its debt instruments to finance public homes for the support and care of honorably discharged veterans of the United States armed forces. Such homes will be established only if Federal Veterans' Administration funds are available to provide a share of the construction and operation costs. Prior to the issuance of any debt instruments, the Veterans' Homes Board must receive the approval of the Funding Board.

All outstanding bonds of the Veterans' Homes Board were refunded and defeased by the State of Tennessee with the General Obligation Bonds, 2003 Series A.

THE TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

The Tennessee Consolidated Retirement System ("TCRS") was established in 1972 to administer a retirement program for the public employees of the State. In 1972, the seven existing State retirement systems were closed, and all assets and liabilities of these superseded systems were transferred to the TCRS. TCRS provides retirement, disability and death benefits to TCRS members and their beneficiaries. These benefits are available to members at various times depending on their ages and creditable service records. Benefits are determined by a formula using the highest five-year average salary and years of service of each employee. Benefits are funded from contributions of members and employers. Contributions are determined on an actuarial reserve basis and provide funding for both normal and accrued liability costs. Effective July, 1981, pursuant to noncontributory legislation, contributions of up to five percent (5%) of the earnable compensation of most classes of general employees, formerly paid by those employees, were assumed by the State.

Through June 30, 2004, employers contributed \$411.1 million to TCRS while contributory members contributed \$204.9 million. The earnings on investments equaled a \$2.2 billion gain for the System through June 30, 2004. As a result of the positive cash flow for the TCRS, the reserves increased to \$25.6 billion as of June 30, 2004. The investment objective for TCRS is to obtain the highest available return on investments consistent with the preservation of principal while maintaining sufficient liquidity to react to the changing environment and to pay beneficiaries in a timely manner. TCRS emphasizes a conservative, high quality portfolio to ensure the soundness of TCRS and the ability to provide the needed funds upon a member's retirement. Funds in TCRS are actively managed with a diversified portfolio of high quality domestic and international stocks and bonds, mortgages and money market instruments. The investment policy of TCRS is established by the Board of Trustees of TCRS and may be more restrictive than the statutory authority.

An experience study of TCRS is conducted every four years. A new experience study was conducted as of June 30, 2000. The results of the 2001 actuarial valuation became effective on July 1, 2002. The investment assumption remains at 7 1/2% while the annual salary growth rate was reduced to approximately 4 3/4% as a result of a revised age graded salary scale.

In addition, an actuarial valuation is made every two years. The actuarial valuation as of July 1, 2001, incorporated the 2000 assumptions. For actuarial purposes, investments were valued using a five-year moving market average. With the 2001 actuarial valuation the accrued liability was reestablished. This was accomplished by setting the unfunded accrued liability equal to the excess of the Entry Age Normal Past Service Liability over the valuation assets. An actuarial valuation was performed on July 1, 2003 and the results have been incorporated into contribution rates effective July 1, 2004.

The accrued liability of TCRS, based on the present value of benefits for past and future service, was estimated to be \$367.6 million at June 30, 2004. Of this accrued liability, \$49.6 million is attributable to the State of Tennessee. As of June 30,

2003, TCRS had 198,917 active members and 83,121 retired members: as of June 30, 2004, TCRS had 200,000 active members and 86,361 retired members.

The Governmental Accounting Standard Board "GASB" issued Statement No. 25 "*Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*", requiring information in the notes to the financial statements relating to the funding progress of a pension plan. Expressing the unfunded actuarial accrued liability as a percentage of annual covered payroll approximately adjusts for the effect of inflation and aids analysis of the progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage is, the stronger the system is.

The fiscal year ended June 30, 2004 is presented in accordance with GASB Statement No. 25 as follows:

SETHEEPP/PSPP (Unaudited)

Schedules of Funding Progress
(Dollars Expressed in Thousands)

	Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Frozen Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a-b)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll (b-a)/c
SETHEEP	07/01/03	\$22,099,252	\$22,151,745	\$52,493	99.76%	\$4,773,297	1.10%
	07/01/01	20,760,989	20,842,216	81,227	99.61%	4,451,452	1.82%
	07/01/99	18,327,133	18,420,156	93,023	99.49%	4,132,409	2.25%
	06/30/97	15,671,678	15,782,850	111,172	99.30%	3,810,231	2.92%
PSPP	07/01/03	3,605,526	3,923,475	317,946	91.90%	1,731,135	18.37%
	07/01/01	3,187,990	3,528,137	340,147	90.36%	1,545,593	22.01%
	07/01/99	2,690,781	2,890,942	200,161	93.08%	1,341,363	14.92%
	06/30/97	2,226,891	2,287,904	61,013	97.33%	1,130,585	5.40%

The SETHEEP (State Employees, Teachers and Higher Education Employees Pension Plan) is comprised of a number of employee groups. However, the unfunded liability of \$52.5 million at July 1, 2003 is attributable to two employee groups: 1) County Officials employed prior to July 1, 1972 and 2) State Judges and Attorney General employed prior to July 1, 1972. The PSPP (Political Subdivision Pension Plan) represents 446 participating entities at July 1, 2003. The unfunded liability of \$317.9 million is attributable to 353 of the 446 entities.

[Remainder of page intentionally left blank. Official Statement continues on following page.]

The information presented in the required supplementary Schedule of Funding Progress was determined as part of the latest actuarial valuations as of July 1, 2003. Additional information follows:

	SETHEEPP (Unaudited)	PSSP (Unaudited)
Valuation Date	7/1/2003	7/1/2003
Actuarial cost method	Frozen Entry Age	Frozen Entry Age
Amortization method	Level Dollar	Level Dollar
Remaining amortization period	12 Years closed period	(1) closed period
Asset valuation method	5-year Moving Market Average	5-year Moving Market Average
Actuarial assumptions:		
Investment rate of return	7.50%	7.50%
Projected salary increases	4.75%(3)	4.75%(3)
Includes inflation at	(2)	(2)
Cost-of-living adjustments	3.00%	3.00%
Increase in Social Security wage base	3.50%	3.50%

- (1) The length of the amortization period varies by political subdivision. For political subdivisions entering the plan on or after July 1, 1994, the amortization period does not exceed 20 years
- (2) No explicit assumption is made regarding the portion attributable to the effect of inflation on salaries
- (3) Uniform rate that approximates the effect of a graded salary scale.

LITIGATION

Due to its size and broad range of activities, the State and its officers and employees are involved in a number of legal actions. In view of the financial condition of the State, except with respect to *Tennessee Small Schools System v. Tennessee Commissioner of Education* and the disputed Federal financial participation in TennCare discussed below, it is the opinion of the Commissioner of Finance and Administration that the State's financial condition will not be materially affected by such litigation, based on information known at the date of this Official Statement.

In *Tennessee Small Schools System v. Tennessee Commissioner of Education et al.* (Davidson Chancery Court, Docket No. 88-1812-II), plaintiffs asserted that the State has not complied with a 1994 Tennessee Supreme Court decision that required the State to "equalize" teachers' salaries according to a certain formula. In October 2002, the Supreme Court ruled in favor of the plaintiffs and held that the State's teacher salary equity plan failed to comply with the State's constitutional obligation to formulate and maintain a system of public education that afforded substantially equal educational opportunity to all Tennessee K-12 students. The State has complied with the order by appropriating money in the 2003 and 2004 legislative sessions to teacher pay equalization. To the extent that additional funds are needed to comply with the Supreme Court's 2002 order, the funds will be appropriated in the regular budget process.

On January 1, 1994, after receiving a waiver from the United States Department of Health and Human Services, the State replaced a substantial portion of its Medicaid Program with a managed care demonstration project called TennCare. TennCare is the subject of litigation.

The following four TennCare related class actions are all encompassed in a global settlement, the terms of which have been approved by the Governor, Comptroller, Attorney General, and Speakers and presented to and approved by the respective courts in which the cases are pending. The terms of the global settlement are set out following this listing of the individual cases. *Grier, et al. v. Goetz, et al.* (U.S. District Court, M. D. Tenn.) deals with the procedural protections to be

afforded all enrollees when TennCare services are denied, delayed, suspended, or terminated. A revised consent decree, entered on October 26, 1999 and modified by order entered September 25, 2003, sets out due process requirements. *Rosen, et al. v. Commissioner of Finance and Administration* (U.S. District Court, M. D. Tenn.), a class action filed on behalf of all waiver eligible TennCare enrollees, deals with the due process protections to be afforded to persons whose TennCare applications are denied or whose TennCare coverage is terminated. An order entered in December 2002 ordered the reinstatement of all of the approximately 200,000 enrollees who had been terminated during the redetermination process that began July 1, 2002, and effectively precluded implementation of the new TennCare waiver. The State appealed to the Court of Appeals for the Sixth Circuit, which granted a stay of that order pending appeal. *John B., et al. v. Goetz, et al.* (U.S. District Court, M. D. Tenn.) is a class action brought on behalf of all TennCare enrollees under the age of 21, alleging that the State was not meeting its obligation to provide these children with the early and periodic screening, diagnosis, and treatment (EPSDT) services required by the federal Medicaid Act. The case was settled by a consent decree in March 1998. In an opinion filed in December 2001, following a hearing on plaintiffs' motion for a finding of contempt, the court found that the State was in violation of federal EPSDT law. A special master was appointed by the court to assist it in monitoring the State's compliance. In a recent development not affected by the global settlement, plaintiffs have filed a motion for a hearing on the current status of the State's compliance with the consent decree. *Newberry, et al. v. Goetz, et al.* (U.S. District Court, M. D. Tenn.) is a class action filed as a challenge to TennCare policies and practices related to the provision of home health services to enrollees. The complaint was later expanded to challenge a proposed limit of 125 health visits a year.

The terms of the global settlement with respect to each of the above cases are as follows: In *Grier*, the principal feature of the agreement is a time-limited modification of the pharmacy provisions of the revised consent decree, shortening from two weeks to three days the minimum amount of prescribed medications that must be dispensed to an enrollee on an interim basis. In *Rosen*, the State has agreed to extend a grace period for reapplication to all former TennCare enrollees who lost their coverage as a result of the redetermination process that began July 1, 2002. The benefit reductions and cost sharing increases that were to have gone in effect under the new TennCare waiver have been withdrawn. In an order entered October 15, 2003, the District Court set aside its order of December 18, 2002. In *John B.*, the benefits reductions that were to have taken effect under the new waiver and which have now been withdrawn included the elimination of EPSDT coverage for non-Medicaid eligible children. The District Court was notified of the withdrawal of the proposed benefits reduction. In *Newberry*, the State must ensure that TennCare enrollees receive home health care from the MCOs as medically necessary. The settlement also provides for the withdrawal of the proposed reduction of home health care benefits and the proposed elimination of private duty nursing benefits. The financial impact on the State of these changes will depend on the at-risk status of the MCOs and the level of utilization of these services. A further aspect of the settlement agreement, although it is not a term that is judicially enforceable, is the State's commitment to work to develop home and community-based alternatives to nursing home placement. An express condition of that agreement is that it must be budget neutral to the State.

In *Universal Care of Tennessee, Inc. v. M.D. Goetz and Manny Martins, in their Official Capacities*, (Tennessee Claims Commission No. 20301822), Universal Care, a former managed health care company, claims the State did not act in good faith and breached its TennCare contract by failing to pay actuarially sound rates sufficient to cover the health care costs of the TennCare enrollees served by Universal. The company, which is now insolvent and in receivership, is seeking approximately \$100 million in damages in a claim that the State will vigorously defend.

Brown v. Tenn. Dept. of Finance and Administration (U.S. District Court, Middle District of Tennessee, No. 3-00-0665) is a class action filed on behalf of individuals with mental retardation and other developmental disabilities waiting for services to which they are entitled under the Medicaid program. The State currently has at least 2,900 persons on a waiting list for these services. The plaintiffs assert that the statutory limit on the number of ICF/MR beds and the restriction on the number of individuals able to be served under the Home and Community-Based Services Waiver violate the right of eligible Tennesseans to receive services in an adequate amount, duration and scope and with reasonable promptness as required by the Medicaid Act. The U.S. District Court has approved a settlement agreement. This agreement requires the State to seek a new Home and Community Based Services Medicaid waiver that would be capped at \$30,000 per year per person and incorporate self-determination principles. The State is also required to provide state-funded consumer directed supports with an annual cap of \$5 million and targeted case management services to class members on a waiting list for services. Until a new waiver is approved, the State must provide services with state dollars with a cap of \$500,000 per month. Once the waiver is approved, the State will serve 600 persons in the first year and 900 persons in the second year (with federal matching dollars at approximately 66%). The State will then negotiate regarding the need to expand the waiver to serve the remaining individuals on the waiting list with reasonable promptness. The estimated expense to the State in the first year is \$18 million in state dollars. There will be some increase in costs in the subsequent years since the State must continue to provide services to enrollees while adding new enrollees.

United State of America v. State of Tennessee (Arlington Developmental Center) (U.S. District Court, W.D.) is a case brought pursuant to the Civil Rights of Institutionalized Persons Act, alleging that the constitutional rights of residents at Arlington were being violated. The trial was in August, 1993. A remedial order was approved on September 1, 1994. Since entry of the remedial order, six separate contempt actions have been filed. Some of these have resulted in fines against the State. The court subsequent to the remedial order has issued an order interpreting the third category of the definition of class, i.e., persons at risk of being placed at Arlington Developmental Center, to consist of all individuals who reside in West Tennessee and who have demonstrated medical needs sufficient to require institutional care in the absence of home or community-based services. This interpretation increases the number of class members from 452 to an estimated 3,000. A notice of appeal was filed with the 6th Circuit Court of Appeals and a stay granted. An agreement to resolve this issue was not approved by the District Court.

On December 19, 1994, the Health Care Financing Administration, currently the Centers for Medicare and Medicaid Services (“CMS”), notified the State that the State’s inclusion of amounts received from its nursing home bed tax and services tax in computing the amount of Federal financial participation was under review and was possibly inconsistent with Federal methodology for such computation due to an alleged impermissible “hold harmless” State grant arrangement. On January 19, 2001, the State received notice of disallowance relating to the nursing home bed tax of Federal funds in the amount of \$519,864,853 for the period October 1992 through September 2000. On June 11, 2001, the State received a second notice of disallowance relating to the nursing home bed tax in the amount of \$32,744,000 for the period October 2000 through March 2001. The State is appealing administratively CMS’s assertion of improper computation of the amount of Federal financial participation. If it were ultimately determined that the State’s inclusion of these taxes was inconsistent with Federal methodology for such computation, then CMS would offset the disallowed amounts against future Federal participation in TennCare. The State eliminated the State grant arrangement as of August 1, 2001, and does not believe that its inclusion of these taxes after that date will be challenged by CMS.

At this time there is one lawsuit pending against the State of Tennessee that could affect the tobacco settlement payments. The original complaint was dismissed but the plaintiffs are appealing. In addition, the Independent Auditor responsible for disbursing settlement payments may elect to preliminarily make adjustments to the State's tobacco settlement payments without resorting to litigation. These potential adjustments, most notably relating to volume and non-participating manufacturers, have been made in the past and may be made in the future. Also, tobacco companies could unilaterally withhold payments owed to the State. The State may vigorously dispute any such adjustments or withholdings, but it could take years to have those disputes resolved. Lastly, litigation in other states may have a material effect on the tobacco settlement payments to the State.

TAX MATTERS

Federal Tax Matters

General

In the opinion of Hawkins Delafield & Wood LLP, Bond Counsel to the State, under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein, (i) interest on the Series C Bonds is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the “Code”), and (ii) interest on the Series C Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. In rendering its opinion, Bond Counsel has relied on certain representations, certifications of fact, and statements of reasonable expectations made by the State in connection with the Series C Bonds, and Bond Counsel has assumed compliance by the State with certain ongoing covenants to comply with applicable requirements of the Code to assure the exclusion of interest on the Series C Bonds from gross income under Section 103 of the Code.

Bond Counsel expresses no opinion regarding any other Federal tax consequences with respect to the Series C Bonds. Bond Counsel renders its opinion under existing statutes and court decisions as of the issue date, and assumes no obligation to update its opinion after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation or

otherwise. Bond Counsel expresses no opinion as to the effect of any action hereafter taken or not taken, in reliance upon an opinion of other counsel, on the exclusion from gross income for Federal income tax purposes of interest on the Series C Bonds.

For the proposed form of opinion of Bond Counsel relating to Federal tax matters, see Appendix C.

Certain Ongoing Federal Tax Requirements and Covenants

The Code establishes certain ongoing requirements that must be met subsequent to the issuance and delivery of the Series C Bonds in order that interest on the Series A Bonds be and remain excluded from gross income under Section 103 of the Code. These requirements include, but are not limited to, requirements relating to use and expenditure of gross proceeds of the Series C Bonds, yield and other restrictions on investments of gross proceeds, and the arbitrage rebate requirement that certain excess earnings on gross proceeds be rebated to the Federal government. Noncompliance with such requirements may cause interest on the Series C Bonds to become included in gross income for Federal income tax purposes retroactive to their issue date, irrespective of the date on which such noncompliance occurs or is discovered. The State has covenanted to comply with certain applicable requirements of the Code to assure the exclusion of interest on the Series C Bonds from gross income under Section 103 of the Code.

Certain Collateral Federal Tax Consequences

The following is a brief discussion of certain collateral Federal income tax matters with respect to the Series C Bonds. It does not purport to address all aspects of Federal taxation that may be relevant to a particular owner of a Series C Bond. Prospective investors, particularly those who may be subject to special rules, are advised to consult their own tax advisors regarding the Federal tax consequences of owning and disposing of the Series C Bonds.

Prospective owners of the Series C Bonds should be aware that the ownership of such obligations may result in collateral Federal income tax consequences to various categories of persons, such as corporations (including S corporations and foreign corporations), financial institutions, property and casualty and life insurance companies, individual recipients of Social Security and railroad retirement benefits, individuals otherwise eligible for the earned income tax credit, and taxpayers deemed to have incurred or continued indebtedness to purchase or carry obligations the interest on which is excluded from gross income for Federal income tax purposes. Interest on the Series C Bonds may be taken into account in determining the tax liability of foreign corporations subject to the branch profits tax imposed by Section 884 of the Code.

Bond Premium

In general, if an owner acquires a Series C Bond for a purchase price (excluding accrued interest) or otherwise at a tax basis that reflects a premium over the sum of all amounts payable on that Series C Bond after the acquisition date (excluding certain "qualified stated interest" that is unconditionally payable at least annually at prescribed rates), that premium constitutes "bond premium" on that Series C Bond (a "Premium Bond"). In general, under Section 171 of the Code, an owner of a Premium Bond must amortize the bond premium over the remaining term of the Premium Bond, based on the owner's yield over the remaining term of the Premium Bond, determined based on constant yield principles (in certain cases involving a Premium Bond callable prior to its stated maturity date, the amortization period and yield may be required to be determined on the basis of an earlier call date that results in the lowest yield on such bond). An owner of a Premium Bond must amortize the bond premium by offsetting the qualified stated interest allocable to each interest accrual period under the owner's regular method of accounting against the bond premium allocable to that period. In the case of a tax-exempt Premium Bond, if the bond premium allocable to an accrual period exceeds the qualified stated interest allocable to that accrual period, the excess is a nondeductible loss. Under certain circumstances, the owner of a Premium Bond may realize a taxable gain upon disposition of the Premium Bond even though it is sold or redeemed for an amount less than or equal to the owner's original acquisition cost.

Owners of any Premium Bonds should consult their own tax advisors regarding the treatment of bond premium for Federal income tax purposes, including various special rules relating thereto, and State and local tax consequences, in connection with the acquisition, ownership, amortization of bond premium on, sale, exchange or other disposition of Premium Bonds.

Possible Government Action

Legislation affecting municipal bonds is regularly under consideration by the United States Congress. In addition, the Internal Revenue Service has established an expanded audit program for tax-exempt bonds. There can be no assurance that

legislation enacted or proposed or an audit initiated by the Internal Revenue Service, involving either the Series C Bonds or other tax-exempt bonds, after the date of issuance of the Series C Bonds will not have an adverse effect on the tax-exempt status or market price of the Series C Bonds.

State of Tennessee Tax Matters

In the opinion of Bond Counsel to the State, under existing laws of the State, the Bonds and the interest thereon are free from taxation by the State or any county, municipality or taxing district of the State, except for inheritance, transfer and estate taxes and except to the extent such interest may be included within the measure of privilege taxes imposed pursuant to the laws of the State.

Bond Counsel expresses no opinion regarding any other state or local tax consequences with respect to the Bonds. Bond Counsel renders its opinion under existing statutes and court decisions as of the issue date and assumes no obligation to update its opinion after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation or otherwise. Bond Counsel expresses no opinion as to the effect of any action hereafter taken or not taken, in reliance upon an opinion of other counsel, under state and local tax law.

For the proposed form of opinion of Bond Counsel relating to State tax matters, see Appendix C.

FINANCIAL ADVISOR

Public Financial Management, Inc. ("PFM") is employed by the State to perform professional services in the capacity of financial advisor. In its role as financial advisor to the Funding Board, PFM provided advice on the plan of financing and structure of the Bonds, reviewed certain legal and disclosure documents, including this Official Statement, for financial matters, and reviewed and gave an opinion on the fairness of the pricing of the bonds by the underwriting syndicate. PFM has not independently verified the factual information contained in this Official Statement, but relied on the information supplied by the State, other sources and the State's certification as to the Official Statement.

VERIFICATION AGENT

The accuracy of the arithmetical computations of the adequacy of the cash and maturing principal and interest earned on the Government Obligations deposited in the Refunding Trust Fund to pay, when due, the principal of, premium if any, and interest on the Refunded Bonds and arithmetical computations supporting the conclusion that the Bonds are not "arbitrage bonds" within the meaning of Section 148 of the Internal Revenue Code of 1986, as amended, will be verified by McGladrey & Pullen LLP, a firm of independent certified public accountants.

UNDERWRITING

UBS Financial Services Inc., as representative and on behalf of the Underwriters, has agreed to purchase and to pay a net purchase price for the Series C Bonds of \$238,049,296.02 (representing an aggregate principal amount of \$215,165,000.00 plus a net original issue premium of \$23,433,441.25 less Underwriters' discount of \$549,145.23), plus accrued interest to the delivery date.

The prices and other terms respecting the offering and sale of the Bonds may be changed from time to time by the Underwriters after such Bonds are released for sale, and the Bonds may be offered and sold at prices other than the initial offering prices, including sales to dealers who may sell the Bonds into investment accounts.

RATINGS

Fitch Ratings, Moody's Investors Service, Inc., and Standard & Poor's Ratings Services have given the Bonds ratings of AA, Aa2, and AA, respectively. Such ratings reflect only the respective views of such organizations and an explanation of the

significance of a rating may be obtained only from the rating agency furnishing the same. There is no assurance that any rating will be maintained for a given period of time or that it will not be revised downward or withdrawn entirely by the rating agency if in its judgment, circumstances so warrant. Any such downward revision or withdrawal of ratings may have an adverse affect on the market price of the Bonds.

APPROVING LEGAL OPINIONS

The validity of the Bonds will be approved by legal opinions of Hawkins Delafield & Wood LLP, New York, New York, Bond Counsel to the State. For the proposed form of Bond Counsel opinion relating to the Bonds, see Appendix C. Certain legal matters will be passed upon by the Attorney General and Reporter of the State of Tennessee, as counsel to the Funding Board. Certain legal matters will be passed upon for the Underwriters by their counsel, Bass, Berry & Sims, PLC, Nashville, Tennessee. No representation is made to the holders of the Bonds that any of such counsel have verified the accuracy, completeness or fairness of the statements in this Official Statement, and such counsel assume no responsibility to the holders of the Bonds except for the matters that will be set forth in their respective opinions.

CONTINUING DISCLOSURE

The State has authorized a Continuing Disclosure Undertaking (the “Undertaking”) with respect to the Bonds to assist the Underwriters in complying with U.S. Securities and Exchange Commission Rule 15c2-12(b)(5) (the “Rule”). The Undertaking will be for the benefit of the holders of the Bonds, and beneficial owners will be third-party beneficiaries thereof. The form of the undertaking is included herein as Appendix E.

The State has not failed to comply in any material respect with any previous undertaking in a written contract or agreement specified in the Rule.

MISCELLANEOUS

Any statements in this Official Statement involving matters of opinion or estimates, whether or not expressly so stated, are intended as such and not as representatives of fact. No representation is made that such statements will be realized.

All financial and other information presented in this Official Statement has been provided by the State from its records, except for information expressly attributed to other sources. The presentation of information, including tables of receipts from taxes and other revenues, is intended to show recent historic information, and it is not intended to indicate future or continuing trends in the financial position or other affairs of the State. No representation is made that past experience, as it might be shown by such financial and other information, will necessarily continue or be repeated in the future.

References to and summaries of provisions of the Constitution and laws of the State or of any other documents referred to in this Official Statement are qualified in their entirety by reference to the complete provisions thereof.

This Official Statement is not to be construed as a contract or agreement between the State and the purchasers or holders of any of the Bonds.

STATE OF TENNESSEE

By: /s/ John G. Morgan
Comptroller of the Treasury;
Secretary of the Funding
Board of the State of
Tennessee

Financial Statements

The Comprehensive Annual Financial Report (“CAFR”) of the State, including the audited Basic Financial Statements, for the fiscal year ended June 30, 2003 has been filed with each nationally recognized municipal securities information repository (“NRMSIR”)(see “Continuing Disclosure”) and is obtainable from them in accordance with their respective procedures. A printed version is also available upon request to the Funding Board, James K. Polk State Office Building, Suite 1600, 505 Deaderick Street, Nashville, Tennessee 37243-0273, telephone (615) 401-7872, fax (615) 741-5986. The CAFR has been posted on the State’s website at www.state.tn.us/finance/act/cafr.html.

The following reports, each of which are included in the CAFR and have been posted on the State’s website, are incorporated herein by reference:

Auditor’s Report

Management’s Discussion and Analysis

Government-wide Financial Statements:

Statement of Net Assets

Statement of Activities

Fund Financial Statements:

Balance Sheet-Governmental Funds

Statement of Revenues, Expenditures, and Changes in Fund Balances-Governmental Funds

Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities

Statement of Net Assets-Proprietary Funds

Statement of Revenues, Expenses, and Changes in Fund Net Assets-Proprietary Funds

Statement of Cash Flows-Proprietary Funds

Statement of Fiduciary Net Assets-Fiduciary Funds

Statement of Changes in Fiduciary Net Assets-Fiduciary Funds

Required Supplementary Information:

Schedule of Revenues, Expenditures, and Changes in Fund Balances-Budget and Actual-Major Governmental Funds

Reconciliation of Budget to GAAP-Note to RSI

Infrastructure Assets Reported Using the Modified Approach

Notes to the Financial Statements:

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Statistical and Economic Data

The Comprehensive Annual Financial Report (“CAFR”) of the State, including selected statistical data (unaudited), for the fiscal year ended June 30, 2003 has been filed with each nationally recognized municipal securities information repository (see “Annual Audits; Secondary Market Disclosures”) and is obtainable from them in accordance with their respective procedures. A printed version is also available upon request to the Funding Board, James K. Polk State Office Building, Suite 1600, 505 Deaderick Street, Nashville, Tennessee 37243-0273, telephone (615) 401-7872, fax (615) 741-5986. The CAFR has been posted on the State’s website at www.state.tn.us/finance/act/cafr.html.

The following statistical data, all of which is included in the CAFR and has been posted on the State’s website, is incorporated herein by reference:

Revenue by Source and Transfers In – All Governmental Fund Types

Expenditures by Function and Transfers Out – All Governmental Fund Types

Tax Revenues by Source – All Governmental Fund Types

Description of Tax Sources – All Governmental Fund Types

Ratio of Net General Long-Term Debt to Assessed Value and Net Debt Per Capita

Computation of Legal Debt Service Margin

Ratio of Annual Debt Service for General Long-Term Debt to Total Expenditures – All Governmental Fund Types

Schedule of Revenue Bond Coverage – Component Units – Tennessee Housing Development Agency and College and University Funds

Schedule of Fees/Charges, Legislative Appropriations and Debt Service

Economic Characteristics

Tennessee's Economic Growth

Manufacturing

Industrial Growth in Tennessee

Agriculture

Population and Employment Trend

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Form of Proposed Opinion of Bond Counsel

September 30, 2004

The Honorable Governor and Members of
the Funding Board of the State of Tennessee
Nashville, Tennessee 37243

Dear Sirs:

STATE OF TENNESSEE GENERAL OBLIGATION BONDS 2004 REFUNDING SERIES C, \$215,165,000

At your request we have examined into the validity of \$215,165,000 General Obligation Bonds, 2004 Refunding Series C (the "Bonds") of the State of Tennessee (the "State"). The Bonds are dated as of August 15, 2004, and mature, are payable and bear interest, all as provided in the resolution of the Funding Board hereinafter mentioned.

The Bonds recite that they are issued under and pursuant to and in full compliance with the Constitution and laws of the State, including specifically Title 9, Chapter 9, Tennessee Code Annotated, various Public Acts of the General Assembly of the State of Tennessee, and a resolution adopted by the Funding Board of the State of Tennessee on April 15, 2004, as amended on August 12, 2004, to provide for the refunding of certain of the State's outstanding general obligation bonds.

We have examined the Constitution and statutes of the State; certified copies of proceedings of the Funding Board of the State of Tennessee and Public Acts of the General Assembly of the State of Tennessee authorizing the issuance of the Bonds, and an executed Bond, and have made such other examination of law and fact, as we have considered appropriate for purposes of this opinion.

Based on the foregoing, we are of the opinion that:

(1) The Bonds have been authorized and issued in accordance with the Constitution and laws of the State, and constitute valid general obligations of the State for the payment of which as to both principal and interest the full faith and credit of the State is pledged. As additional security for all of the Bonds and interest thereon there is also pledged the annual proceeds of a tax of up to five cents per gallon upon gasoline; the annual proceeds of a special tax of one cent per gallon on petroleum products; one-half of the annual proceeds of motor vehicle registration fees now or hereafter required to be paid to the State, and the annual proceeds of the franchise taxes imposed by the franchise tax law of the State. All of the Bonds, together with interest thereon, are entitled to the benefit of the foregoing taxes, fees, and revenues and to share therein pro rata with any other obligations of the State that might be entitled to share therein as provided by Sections 9-9-101 to 9-9-208, inclusive, Tennessee Code Annotated. The State has not waived immunity from suit or extended its consent to be sued. Monetary actions against the State for breach of contractual obligations may be heard and determined under current law exclusively in the Tennessee Claims Commission, an administrative tribunal, where the State may be liable only for actual damages and certain costs.

(2) Under existing statutes and court decisions, interest on the Bonds is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), and under the Code, such interest is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations; such interest, however, is includable in the adjusted earnings of certain corporations for purposes of calculating the alternative minimum tax imposed with respect to such corporations. In rendering the opinions in this paragraph (2), we have relied on certain representations, certifications of fact, and statements of reasonable expectations made by the State in connection with the Bonds, and have assumed compliance by the State with certain ongoing covenants to comply with applicable requirements of the Code to assure the exclusion of the interest on the Bonds from gross income under Section 103 of the Code. Under the Code, noncompliance with such requirements may cause the interest on the Bonds to be included in gross income for

Federal income tax purposes retroactive to the date of issuance thereof, irrespective of the date on which such noncompliance occurs or is discovered.

(3) Under the existing laws of the State, the Bonds and the interest thereon are free from taxation by the State or any county, municipality or taxing district of the State, except for inheritance, transfer and estate taxes and except to the extent such interest may be included within the measure of privilege taxes imposed pursuant to the laws of the State.

The opinions expressed in paragraph (1) above are subject to applicable bankruptcy, insolvency, reorganization, moratorium and other laws heretofore or hereafter enacted affecting creditors' rights, and are subject to the application of principles of equity relating to or affecting the enforcement of contractual obligations, whether such enforceability is considered in a proceeding in equity or at law.

We express no opinion herein as to (i) Federal, state or local tax consequences arising with respect to the Bonds, or the ownership or disposition thereof, except as stated in paragraphs (2) and (3) above, (ii) the effect of any action taken or not taken, in reliance upon an opinion of other counsel, on the exclusion from gross income for Federal income tax purposes of interest on the Bonds, or under state or local tax law, or (iii) the accuracy, adequacy, sufficiency or completeness of the Official Statement dated August 18, 2004 (or any update or amendment thereof or supplement thereto) relating to the Bonds, or any other financial or other information which has been or may be supplied to purchasers or prospective purchasers of the Bonds.

This opinion is issued as of the date hereof, and we assume no obligation to update, revise or supplement this opinion to reflect any future action, fact or circumstance, or change in law or interpretation or otherwise.

Very truly yours,

BOOK-ENTRY ONLY SYSTEM

The Depository Trust Company (“DTC”), New York, New York, will act as securities depository for the Bonds. The Bonds will be issued as fully-registered bonds registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Bond certificate will be issued for each maturity of the Bonds bearing interest at each interest rate, each in the aggregate principal amount of such maturity bearing interest at such rate, and will be deposited with DTC.

DTC is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds securities that its participants (“Direct Participants”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities through electronic computerized book-entry transfers and pledges between Direct Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (“DTCC”). DTCC, in turn, is owned by a number of Direct Participants of DTC and members of the National Securities Clearing Corporation, Government Securities Clearing Corporation, MBS Clearing Corporation, and Emerging Markets Clearing Corporation (NSCC, GSCC, MBSCC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“Indirect Participants”). The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC’s records. The ownership interest of each actual purchaser of each Bond (“Beneficial Owner”) is in turn to be recorded on the Direct and Indirect Participant’s records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC’s records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holding on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory and regulatory requirements as may be in effect from time to time. Beneficial Owners of Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Bond documents. For example, Beneficial Owners of Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to Bonds unless authorized by a Direct Participant in accordance with DTC’s procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the State as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.’s consenting or voting rights to those Direct Participants to whose accounts the Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the State or any Paying Agent, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name", and will be the responsibility of such Participant and not of DTC or the State or any Paying Agent, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the State or any Paying Agent, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct or Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the Bonds at any time by giving reasonable notice to the State. Under such circumstances, in the event that a successor securities depository is not obtained, Bond certificates are required to be prepared and delivered.

The State may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, Bond certificates will be prepared and delivered to DTC.

THE FOREGOING INFORMATION CONCERNING DTC AND DTC'S BOOK-ENTRY ONLY SYSTEM HAS BEEN OBTAINED FROM DTC, A SOURCE THAT STATE BELIEVES TO BE RELIABLE, BUT THE STATE TAKES NO RESPONSIBILITY FOR THE ACCURACY THEREOF. NEITHER THE STATE, THE UNDERWRITERS, NOR THE PAYING AGENT AND REGISTRAR CAN MAKE ANY ASSURANCE THAT DTC OR THE DTC PARTICIPANTS WILL ACT IN A MANNER DESCRIBED HEREIN, NOR WILL THEY HAVE ANY RESPONSIBILITY OR OBLIGATION TO THE DTC PARTICIPANTS OR BENEFICIAL OWNERS FOR (1) SENDING TRANSACTION STATEMENTS; (2) MAINTAINING, SUPERVISING OR REVIEWING, OR THE ACCURACY OF, ANY RECORDS MAINTAINED BY DTC OR ANY DTC PARTICIPANT; (3) PAYMENT OR THE TIMELINESS OF PAYMENT BY DTC ANY DIRECT DTC PARTICIPANT, OR BY ANY DIRECT DTC PARTICIPANT OR INDIRECT DTC PARTICIPANT TO ANY BENEFICIAL OWNER OF ANY AMOUNT DUE TO ANY BENEFICIAL OWNER IN RESPECT TO THE PRINCIPAL OR INTEREST ON BONDS; (4) DELIVERY OR TIMELY DELIVERY BY DTC OR ANY DTC PARTICIPANT TO ANY BENEFICIAL OWNER OF ANY NOTICE OR OTHER COMMUNICATIONS TO ANY BENEFICIAL OWNER WHICH IS REQUIRED OR PERMITTED UNDER THE TERMS OF THE BOND DOCUMENTS TO BE GIVEN TO BONDHOLDERS; (5) THE SELECTION OF THE BENEFICIAL OWNERS TO RECEIVE PAYMENT IN THE EVENT OF ANY PARTIAL REDEMPTION OF BONDS; OR (6) ANY ACTION TAKEN BY DTC OR ITS NOMINEE AS THE REGISTERED OWNER OF THE BONDS.

So long as Cede & Co. is the registered owners of the Bonds, as nominee for DTC, references in the Official Statement to the Bondholders or registered owners of the Bonds (other than under the caption "Tax Matters" in the Official Statement) shall mean Cede & Co. or any other DTC nominee, as aforesaid, and shall not mean the Beneficial Owners of the Bonds.

CONTINUING DISCLOSURE UNDERTAKING

This Continuing Disclosure Undertaking (the "Undertaking") is dated and made as of September 30, 2004, by the State of Tennessee (the "State") in connection with the issuance of the State's \$215,165,000 aggregate principal amount of General Obligation Bonds, 2004 Refunding Series C. As authorized by Section 11 of the resolution (the "Bond Resolution") of the Funding Board of the State of Tennessee (the "Funding Board") adopted on April 15, 2004, as amended on August 12, 2004, authorizing the Bonds, the State agrees as follows:

ARTICLE I

Definitions

Section 1.1. Definitions. The following terms used in this Undertaking shall have the following respective meanings:

(1) "Annual Financial Information" means (i) updated versions of the following financial information and operating data contained in, or incorporated by reference pursuant to an Appendix to, the Official Statement with respect to the State, for each fiscal year of the State:

- Collections for Special Taxes
- Total Sales and Use Tax Collections
- Allocation of Sales and Use Tax to Debt Service
- General Obligation Bonds Outstanding
- Maximum and Actual Principal Amounts of Commercial Paper Outstanding
- Outstanding General Obligation Bonded Indebtedness, by Fiscal Year and Maturity
- Outstanding Debt of Certain Agencies and Authorities
 - Tennessee Local Development Authority
 - Tennessee State School Bond Authority
 - Tennessee Housing Development Agency
 - Watkins Institute
 - State Veterans' Homes Board
- Tennessee Consolidated Retirement System
 - Employers and Contributory Members Contributions
 - Reserves
 - Accrued Liability
 - Accrued Liability Attributable to State
 - Active/Inactive Members
 - Supplementary Information:
 - Schedules of Funding Progress (if required)
 - Unfunded Liability by groups (if required)
 - Supplementary Information (if required by use of frozen entry age actuarial method)
 - Additional Information relating to Required Supplementary Information
- The statistical data incorporated by reference in Appendix B to the Official Statement

and (ii) the information regarding amendments to this Undertaking required pursuant to Sections 4.2(c) and (d) of this Undertaking. Annual Financial Information shall include Audited Financial Statements, if available, or Unaudited Financial Statements.

The descriptions contained in clause (i) above of financial information and operating data constituting Annual Financial Information are of general categories or types of financial information and operating data. When such descriptions include information that no longer can be generated because the operations to which it related have been materially changed or discontinued, a statement to that effect shall be provided in lieu of such information.

(2) "Audited Financial Statements" means the annual financial statements of the State, audited by the Comptroller of the Treasury, Division of State Audit, as now required by State law (or such other auditor as hereafter may be required or permitted by State law). Audited Financial Statements shall be prepared in accordance with GAAP.

(3) "Counsel" means Hawkins Delafield & Wood LLP or other nationally recognized bond counsel or counsel expert in federal securities laws, in each case acceptable to the State.

(4) "GAAP" means generally accepted accounting principles for governmental units as prescribed by the Governmental Accounting Standards Board, the Financial Accounting Standards Board, or any successor to the duties and responsibilities of either of them.

(5) "Material Event" means any of the following events with respect to the Bonds, if material:

- (i) principal and interest payment delinquencies;
- (ii) non-payment related defaults;
- (iii) unscheduled draws on debt service reserves reflecting financial difficulties;
- (iv) unscheduled draws on credit enhancements reflecting financial difficulties;
- (v) substitution of credit or liquidity providers, or their failure to perform;
- (vi) adverse tax opinions or events affecting the tax-exempt status of the security;
- (vii) modifications to rights of security holders;
- (viii) bond calls;
- (ix) defeasances;
- (x) release, substitution, or sale of property securing repayment of the securities; and
- (xi) rating changes.

(6) "MSRB" means the Municipal Securities Rulemaking Board established pursuant to the provisions of Section 15B (b) (1) of the Securities Exchange Act of 1934.

(7) "NRMSIR" means, at any time, a then-existing nationally recognized municipal securities information repository, as recognized from time to time by the SEC for the purposes referred to in the Rule. NRMSIRs currently are identified on the SEC website at <http://www.sec.gov/consumer/nrmsir/htm>.

(8) "Official Statement" means the Official Statement dated August 18, 2004, of the State relating to the Bonds.

(9) "Rule" means Rule 15c2-12 promulgated by the SEC under the Securities Exchange Act of 1934 (17 CFR Part 240, §240.15c2-12), as in effect on the effective date hereof, including any official interpretations thereof.

(10) "SEC" means the United States Securities and Exchange Commission.

(11) "SID" means, at any time, a then-existing state information depository, if any, as operated or designated as such by or on behalf of the State for the purposes referred to in the Rule. As of the date hereof, there is no SID.

(12) "Unaudited Financial Statements" means the same as Audited Financial Statements, except that they shall not have been audited.

ARTICLE II

The Undertaking

Section 2.1. Purpose. This Undertaking is being executed, delivered and made solely to assist the underwriters of the Bonds in complying with subsection (b)(5) of the Rule.

Section 2.2. Annual Financial Information.

(a) The State shall provide Annual Financial Information with respect to each fiscal year of the State, commencing with the fiscal year ending June 30, 2004, by no later than 7 months after the end of the respective fiscal year, to each NRMSIR and the SID.

(b) The State shall provide, in a timely manner, notice of any failure of the State to provide the Annual Financial Information by the date specified in subsection (a) above to (i) either the MSRB or each NRMSIR, and (ii) the SID.

Section 2.3 Audited Financial Statements. If not provided as part of Annual Financial Information by the date required by Section 2.2(a) hereof because not available, the State shall provide Audited Financial Statements, when and if available, to each NRMSIR and the SID.

Section 2.4 Notices of Material Events.

(a) If a Material Event occurs, the State shall provide, in a timely manner, notice of such Material Event to (i) either the MSRB or each NRMSIR and (ii) the SID.

(b) Any such notice of a defeasance of Bonds shall state whether the Bonds have been escrowed to maturity or to an earlier redemption date and the timing of such maturity or redemption.

Section 2.5 Additional Disclosure Obligations. The State acknowledges and understands that other State and federal laws, including but not limited to the Securities Act of 1933 and Rule 10b-5 promulgated under the Securities Exchange Act of 1934, may apply to the State and that, under some circumstances, additional disclosures or other action in addition to those required by this Undertaking may be required to enable the State to fully discharge all of its duties and obligations under such laws.

Section 2.6. Additional Information. Nothing in this Undertaking shall be deemed to prevent the State from disseminating any other information, using the means of dissemination set forth in this Undertaking or any other means of communication, or including any other information in any Annual Financial Information or notice of a Material Event hereunder, in addition to that which is required by this Undertaking. If the State chooses to do so, the State shall have no obligation under this Undertaking to update such additional information or include it in any future Annual Financial Information or notice of a Material Event hereunder.

Section 2.7. No Previous Non-Compliance. The State represents that since July 3, 1995, it has not failed to comply in any material respect with any previous undertaking in a written contract or agreement specified in paragraph (b)(5)(i) of the Rule.

ARTICLE III

Operating Rules

Section 3.1. Reference to Other Documents. It shall be sufficient for purposes of Section 2.2 hereof if the State provides Annual Financial Information by specific reference to documents (i) either (1) provided to each NRMSIR existing at the time of such reference and the SID or (2) filed with the SEC, or (ii) if such a document is a "final official statement", as defined in paragraph (f)(3) of the Rule, available from the MSRB.

Section 3.2. Submission of Information. Annual Financial Information may be provided in one document or multiple documents, and at one time or in part from time to time.

Section 3.3. Material Event Notices. Each notice of a Material Event hereunder shall indicate that it is a notice of a Material Event and shall include the CUSIP numbers of the State or the CUSIP numbers of the Bonds.

Section 3.4 Filing with Certain Dissemination Agents. The State may satisfy its obligations hereunder to file any notice, document or information with a NRMSIR or SID by filing the same with any dissemination agent, including any "central post office" or similar entity, assuming or charged with responsibility for accepting notices, documents or information for transmission to such NRMSIR or SID, to the extent permitted by the SEC or SEC staff or required by the SEC. For this purpose, permission shall be deemed to have been granted by the SEC staff if and to the extent the agent has received an interpretive letter, which has not been revoked, from the SEC staff to the effect that using the agent to transmit information to the NRMSIRs and the SID will be treated for purposes of the Rule as if such information were transmitted directly to the NRMSIRs and the SID.

Section 3.5 Transmission of Information and Notices. Unless otherwise required by law and, in the State's sole determination, subject to technical and economic feasibility, the State shall employ such methods of information and notice transmission as shall be requested or recommended by the recipients of the State's information and notices.

Section 3.6 Fiscal Year.

(a) The State's current fiscal year is July 1 - June 30. The State shall promptly notify (i) each NRMSIR and (ii) the SID of each change in its fiscal year.

(b) The State shall provide Annual Financial Information at least annually notwithstanding any fiscal year longer than 12 calendar months.

ARTICLE IV

Effective Date, Termination, Amendment and Enforcement

Section 4.1. Effective Date; Termination.

(a) This Undertaking shall be effective upon the issuance of the Bonds.

(b) The State's obligations under this Undertaking shall terminate upon the legal defeasance, prior redemption or payment in full of all of the Bonds.

(c) This Undertaking, or any provision hereof, shall be null and void in the event that the State (1) receives an opinion of Counsel to the effect that those portions of the Rule which require this Undertaking, or such provision, as the case may be, do not or no longer apply to the Bonds, whether because such

portions of the Rule are invalid, have been repealed, or otherwise, as shall be specified in such opinion, and (2) delivers copies of such opinion to each NRMSIR and the SID.

Section 4.2. Amendment.

(a) This Undertaking may be amended without the consent of the holders of the Bonds, if all of the following conditions are satisfied: (1) such amendment is made in connection with a change in circumstances that arises from a change in legal (including regulatory) requirements, a change in law (including rules and regulations) or in interpretations thereof, or a change in the identity, nature or status of the State or the type of business conducted thereby, (2) this Undertaking as so amended would have complied with the requirements of the Rule as of the date hereof, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances, (3) the State shall have received an opinion of Counsel to the same effect as set forth in clause (2) above, (4) the State shall have received either an opinion of Counsel or a determination by a person, in each case unaffiliated with the State, to the effect that the amendment does not materially impair the interests of the holders of the outstanding Bonds, and (5) the State shall have delivered copies of such opinion(s) and amendment to each NRMSIR and the SID.

(b) This Undertaking may be amended without the consent of the holders of the Bonds if all of the following conditions are satisfied: (1) an amendment to the Rule is adopted, or a new or modified official interpretation of the Rule is issued, after the effective date hereof which is applicable to this Undertaking, (2) the State shall have received an opinion of Counsel to the effect that performance by the State under this Undertaking as so amended will not result in a violation of the Rule as so amended or officially interpreted and (3) the State shall have delivered copies of such opinion and amendment to each NRMSIR and the SID.

(c) To the extent any amendment to this Undertaking results in a change in the categories or types of financial information or operating data provided pursuant to this Undertaking, the first Annual Financial Information provided thereafter shall include a narrative explanation of the reasons for the amendment and the impact of the change in the type of operating data or financial information being provided.

(d) If an amendment is made pursuant to Section 4.2(a) hereof to the accounting principles to be followed by the State in preparing its financial statements, the Annual Financial Information for the fiscal year in which the change is made shall present a comparison between the financial statements or information prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles. Such comparison shall include a qualitative and, to the extent reasonably feasible, quantitative discussion of the differences in the accounting principles and the impact of the change in the accounting principles on the presentation of the financial information.

Section 4.3. Contract; Benefit; Third-Party Beneficiaries; Enforcement.

(a) The provisions of this Undertaking shall constitute a contract with and inure solely to the benefit of the holders from time to time of the Bonds, except that beneficial owners of Bonds shall be third-party beneficiaries of this Undertaking and shall be deemed to be holders of Bonds for purposes of Section 4.3(b) hereof. The provisions of this Undertaking shall create no rights in any person or entity except as provided in this subsection (a).

(b) The obligations of the State to comply with the provisions of this Undertaking shall be enforceable by any holder of outstanding Bonds; however, the holders' rights to enforce the provisions of this Undertaking shall be limited solely to a right, by action in mandamus or for specific performance, to compel performance of the State's obligations under this Undertaking.

(c) Any failure by the State to perform in accordance with this Undertaking shall not constitute a default or an event of default under the Bond Resolution or State law and shall not result in any acceleration of payment of the Bonds, and the rights and remedies provided by the Bond Resolution and applicable State law upon the occurrence of such a default or an event of default shall not apply to any such failure.

(d) This Undertaking shall be construed and interpreted in accordance with the laws of the State, and any suits and actions arising out of this Undertaking shall be instituted in a court of competent jurisdiction in the State; provided, however, that to the extent this Undertaking addresses matters of federal securities laws, including the Rule, this Undertaking shall be construed in accordance with such federal securities laws and official interpretations thereof.

Section 4.4. Effective Date. This Undertaking shall be effective upon the issuance and delivery by the State of the Bonds.

STATE OF TENNESSEE

By _____
Mary-Margaret Collier
Assistant Secretary, Funding Board
of the State of Tennessee, *and*
Director, Division of Bond Finance,
State of Tennessee

